No. 2235.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT.

STANDARD PORTLAND CEMENT CORPORATION, a corporation,

Plaintiff in Error,

vs.

ERNEST E. EVANS, GEORGE COLEMAN and PERCY W. EVANS, partners doing business under the firm name of EVANS, COLEMAN & EVANS,

Defendants in Error.

Brief for Defendants in Error

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Filed.....day of March, A. D. 1913.

....., *Clerk.*

By..... *Deputy Clerk.*

THE BLAIR-MURDOCK COMPANY, 68 FREMONT ST., SAN FRANCISCO, CAL.

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Court of Appeals
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BRIEF FOR DEFENDANTS IN ERROR.

STATEMENT OF FACTS.

This action is upon four promissory notes aggregating thirty-nine thousand dollars, executed by the Plaintiff in Error, Standard Portland Cement Corporation, as maker and endorsed by W. J. Dingee and Irving A. Bachman. The notes are all alike, save as to amounts and payees, and are dated May first, 1908, and are pay-

able one year after date. The payees and the amounts of the notes are respectively:

Evans, Coleman & Evans	$30,000.00
Charles D. Rand	5,000.00
T. R. Stockett	3,000.00
Thomas Graham	1,000.00

The notes were not paid at maturity and were subsequently endorsed to Evans, Coleman & Evans, with the exception of the note they already held. That firm then brought this action.

The complaint is verified, but the defendants Dingee and Bachman filed merely a general denial and were not represented at the trial. The Plaintiff in Error filed an answer specifically denying some of the allegations of the complaint and also setting up new matter by way of an affirmative defense. On the issues presented by this answer the cause was tried. There is practically no conflict in the testimony and the questions of fact involved are wholly as to the inferences to be drawn from the facts directly appearing in evidence.

It appears without conflict that the notes in question were executed in the name of the Plaintiff in Error, Standard Portland Cement Corporation, by its officers, who had been authorized to execute them by resolution of its board of directors. They were executed and delivered for the purpose of purchasing stocks and bonds of a corporation known as the Northwestern Portland Cement Company. Notes to the amount of ninety thousand dollars were executed for this purpose and the

Plaintiff in Error actually received in return the stocks and bonds for whose purchase the notes were issued. Among the notes so executed were those involved in this action.

The defenses to these notes urged by the Plaintiff in Error are three: first and foremost, fraud; second, want of consideration; third, want of authorization for the execution of the notes. This description of the defenses of the Plaintiff in Error is not exactly the language in which its counsel describe them, but we believe that an analysis of the pleadings and of counsel's brief will show that, nevertheless, the foregoing is a correct statement of the defenses urged. We might add in this connection that the defenses of want of consideration and want of authorization for the execution of the notes are in reality defenses incidental to the defense of fraud and form a part of that defense, and that the defense of fraud is the primary and important question of fact in this case.

We believe that none of these defenses are made out by the evidence—in fact that there is not even evidence sufficient to justify a finding that any of them exist, much less to overturn the finding of the lower court that they do not exist. But over and above this, upon the mere statement of the case there arises the question, how is it possible for any of these defenses to be maintained when it appears that the Plaintiff in Error has not returned, or offered to return, the consideration which it received for the notes? One would suppose that it was elementary that a corporation could not deny re-

sponsibility upon notes executed in its name when it fails to return anything of value which it has received for them. Accordingly, upon the merits of the case there are four matters to be considered: first, the defense of fraud; second, the defense of want of consideration; third, the defense of want of authorization for the execution of the notes; and fourth, the effect of the failure of the Plaintiff in Error to return, or to offer to return, the stocks and bonds which it received in consideration for the notes.

In addition to these questions which pertain to the merits of the action and were considered by the court below, there are two other matters, pertinent to this appeal alone, to which we desire to call the attention of this Court before discussing the merits. These matters are: first, that the Plaintiff in Error has failed to incorporate in its bill of exceptions the exceptions which it took to the report of the Referee before whom the action was tried; second, that all of the disputed issues are now foreclosed against the Plaintiff in Error by the judgment against it in the suit in equity hereafter mentioned, which the Plaintiff in Error brought against the Defendants in Error setting up the very defenses which this Court is now asked to review. Our argument, accordingly, will be divided into six main heads: first, the failure of the Plaintiff in Error to incorporate in its bill of exceptions the exceptions which it took to the report of the Referee who tried the cause in the court below; second, the exist-

ence of the judgment in the equity suit between the same parties by which every disputed issue is found adversely to the Plaintiff in Error; third, the defense of fraud; fourth, the defense of want of consideration; fifth, the defense of want of authorization for the execution of the notes; and sixth, the effect of the failure of the Plaintiff in Error to return, or to offer to return, the stocks and bonds which it received in consideration for the notes.

At this point we would say that the bill of exceptions assigns as error certain rulings at the trial admitting or rejecting evidence, and that these same rulings are likewise included in the assignments of error in the brief for Plaintiff in Error. But the brief for the Plaintiff in Error does not discuss or touch upon these rulings and they are not urged as grounds for reversal. The brief is concerned solely with endeavoring to show that the defenses of the Plaintiff in Error are made out from the evidence and that the findings to the contrary are not supported by the evidence. In view of the fact that these rulings upon the introduction of evidence are not urged, and the further fact that they are as to matters of little importance and their propriety is generally quite apparent, we do not discuss them in this brief but confine ourselves to the points stated above.

I.

The failure of the Plaintiff in Error to incorporate in its Bill of Exceptions the exceptions which it took to the Report of the Referee.

Pursuant to a stipulation between the parties (Tr., pp. 119, 121), the lower court ordered (Tr., pp. 121, 123) that the action be tried before the Hon. H. M. Wright, Master in Chancery, as Referee, the Referee to take and hear the evidence and to report the same to the Court with his findings of fact and conclusions of law, such report to be advisory only and to have the same effect as the report of a Master in a suit in equity, and to be subject to confirmation, modification, or rejection by the Court upon exceptions by any party in accordance with the equity practice.

The record shows that the cause was tried before the Referee in accordance with the foregoing stipulation and order and that the Referee made his report and findings of fact and conclusions of law in favor of the Defendants in Error and against the Plaintiff in Error.

The report and findings of the Referee are not set forth in the bill of exceptions, but appear in the transcript on pages 67 to 86 inclusive as part of the judgment-roll. According to the fifth subdivision of Rule 66 of the Rules of the Circuit Court, the report and findings of the Referee are a part of the judgment roll, and

are therefore a proper part of the record on this writ of error. We make no point that they are not.

But it is indisputable that unless the Plaintiff in Error presented to the court below by proper exceptions any objections which it had to the rulings of the Referee at the trial, or to his findings and conclusions, those objections were waived. The bill of exceptions (Tr., p. 980) shows that the Plaintiff in Error did present exceptions to the report of the Referee and to his findings and conclusions, and that these exceptions were overruled. But what the exceptions were which were so presented the bill of exceptions does not show or purport to show.

Now we take it as clear that the Plaintiff in Error cannot call upon this Court to review erroneous rulings and conclusions of the Referee as such. It can call upon this Court to review them only when they have been adopted by the court below and made the action of the court itself. The report of the Referee in this case was but advisory and not final. The final thing was the action of the court itself, and it is this alone that is subject to review here.

The action of the lower court in confirming the report of the Referee cannot be reviewed in this Court upon a record in which the bill of exceptions does not show upon what the lower court acted in confirming the report. This the present record does not do. So far as the bill of exceptions shows, it may well be that the Plaintiff in Error did not, by exceptions to the Referee's report, present any of the objections which it now urges

as a ground for review and reversal. So far as the bill of exceptions shows the exceptions presented to the trial court may have been entirely different from those presented to this Court, and the objections which it now urges may be urged for the first time in this Court.

The printed transcript does contain the exceptions urged in the court below to the Referee's report. (Tr., pp. 87 to 110.) They consisted of the objections to the Referee's report made to the Referee in advance of its filing. These objections, it was subsequently stipulated, should stand as exceptions filed before the Court; but the objections and the stipulation which made them exceptions before the Court are not part of the bill of exceptions. They are part of the printed transcript only because the clerk of the court below took it upon himself to include them as part of the judgment-roll. They are not in reality part of the judgment-roll. Rule 66 of the Circuit Court prescribes what the judgment-roll shall contain, and it does not call for exceptions to a referee's report any more than it calls for the inclusion of any objection or action by a party at a trial preliminary to the final judgment. The rule reads:

> "Immediately after entering the judgment in an action at law the clerk shall attach together and file in the cause the following papers, which shall constitute the judgment-roll, viz.:
>
> . . . . . .
>
> "Fifth. In case the complaint or any amended complaint has been answered by any defendant, the pleadings and all amended pleadings and amendments to

pleadings, and copies of all orders in relation to the amendment of pleadings or of amended pleadings, copies of all orders sustaining or overruling demurrers, copies of all orders in relation to a change, addition, substitution or elimination of parties, copies of all orders striking out pleadings or a part or parts thereof, all notices of election to have any demurrer to a previous pleading stand as the demurrer to a subsequent pleading, the verdict of the jury, if there be a verdict, or the written finding of the Judge, Referee, Commissioner or Master, if there be such, the agreed statement of facts, if there be such, and a copy of the judgment."

It follows that the exceptions to the Referee's report, not being contained in the bill of exceptions, and not being a proper part of the judgment-roll, are not a part of the record before the Court, although they may be printed in the transcript. The cause must be considered as if they did not appear at all.

Lessee of Pomeroy v. *Bank,* 1 Wall. 592; 17 L. Ed. 640;

Metropolitan etc. Co. v. *MacFarland,* 195 U. S. 322; 49 L. Ed. 219.

The exceptions taken to the Referee's report not being before the Court, it follows that the Court cannot review the action of the lower court in acting upon those exceptions and confirming the report. So far as the record shows, every objection now urged to the proceedings before the Referee and to the conclusions reached by him may have been waived by the failure

of the Plaintiff in Error to present such objections to the court below.

Baltimore etc. Co. v. *Trustees,* 1 Otto 127; 23 L. Ed. 260;
Metropolitan etc. Co. v. *MacFarland,* 195 U. S. 322; 49 L. Ed. 219;
Gilbank v. *Stephenson,* 30 Wis. 156;
Reever v. *White,* 8 Utah 188; 30 Pac. 685;
Turley v. *Barnes,* 131 Mo. 548; 33 S. W. 172.

II.

The existence of the judgment in the equity suit between the same parties, by which every disputed issue is determined adversely to the Plaintiff in Error.

The answer of the Plaintiff in Error is, as we have said, divided into two parts. The first part (Tr., pp. 21-39) contains simply denials of certain allegations of the complaint. The second part (Tr., pp. 39-63) is concerned with allegations of new matter. The issues raised by the denials in the first part of the answer were not contested by the Plaintiff in Error and are all covered by the stipulations appearing on pages 916 and 917 of the transcript, save the denial for want of information or belief of the indorsement of Dingee and Bachman. The secretary of the Plaintiff in Error, however, himself testified to such indorsement (Tr., pp. 738-740) and it was never questioned. Accordingly, we

say there is no contested issue raised by the first part of the defendant's answer.

All of the contested issues are raised by the matters alleged in the second part of the answer, that is, the allegations setting up the defense of fraud and, as an incident of the fraud, want of consideration extending to the Plaintiff in Error, and want of authority on the part of its officers to execute its notes.

Subsequent to the filing of the answer, counsel for the Plaintiff in Error were taken with the idea (whether rightly or wrongly is immaterial now) that the defense or defenses presented by the second portion of their answer were equitable in nature and not available in an action at law. (See pp. 1 and 2 of brief for Plaintiff in Error, and pp. 71 and 72 of the transcript.) Acting upon this view the Plaintiff in Error filed its bill against the Defendant in Error on the equity side of the court, setting up the same matters as those set up in the second portion of the answer in the law action, and praying that the prosecution of the action at law be enjoined and that the notes be delivered up and cancelled. (Tr., p. 117.) The Defendant in Error answered the bill and, as stated in the bill of exceptions (Tr., p. 118), the issues so rasied are the same as those presented by the second portion of the answer in the action at law. It was then stipulated by the parties that both the law action and the equity suit should be referred to Mr. Wright for trial and that they should be tried together at one and the same time. (Tr., pp. 119,

120.) An order of reference was made in accordance with this stipulation and both causes were so tried. When Mr. Wright came to make his report and findings in the law action, he found upon the issues presented by the first portion of the answer, but not upon those presented by the second portion, saying, (Tr., p. 80):

> "I intentionally omit to find on other issues presented by the answer herein, for the reason that they present defenses of fraud and other matters of purely equitable cognizance which were not properly pleadable in an answer at law, and which this court has not the power to consider on its law side. The same issues have, however, been presented by the bill in equity filed in said court entitled *Standard Portland Cement Corporation* v. *Ernest E. Evans, George Coleman and Percy W. Evans,* partners doing business under the firm name of Evans, Coleman & Evans, number 15,249, on the equity side of said court, a case tried at the same time with this action, and the said issues have been by my findings in said cause determined adversely to the complainants therein, being the defendants herein."

The bill of exceptions also shows that the Master made his findings adversely to the Plaintiff in Error upon all the issues presented in the equity suit and reported as his conclusions of law that the Plaintiff in Error was not entitled to relief in the suit, that is, that the defenses to the notes urged in the equity suit (and they are all of the defenses urged by the Plaintiff in Error), did not in fact exist. (Tr., pp. 979, 980.)

The bill of exceptions also shows that judgment was entered in the equity suit upon this report against the

Plaintiff in Error, adjudging that it was not entitled to relief by reason of its bill or any of the matters alleged in it. (Tr., p. 982.)

Now these very matters that were alleged in the bill in equity include, as we have said, all of the matters in dispute between the parties. The present situation is, therefore, that it affirmatively appears from the record (a) that all of the issues in dispute between the parties are presented by the second portion of the answer of the Plaintiff in Error, (b) that subsequent to filing that answer the Plaintiff in Error chose to treat those issues as not cognizable in a law action and to present them on the equity side of the court, (c) that after trial, judgment was rendered against the Plaintiff in Error on the equity side and judgment on the law side followed as of course, and (d) that the Plaintiff in Error, instead of appealing from the judgment on the equity side, which adjudicated all the matters in dispute, obtained a writ of error to review the judgment in the law action from which all matters in dispute had been eliminated and in which the findings of the Referee, confirmed and adopted by the court, expressly fail to find as to such matters because they have been eliminated.

It is apparent that under these circumstances there can be no review by this Court of the matters in dispute between the parties. Those matters are not before the Court and the Plaintiff in Error is absolutely foreclosed as to them by a final judgment against it in another pro-

ceeding. The fact is that the Plaintiff in Error has sought to review the wrong judgment.

The point may be made clearer, if this be possible, by assuming that this Court does reverse the judgment in the law action and direct a new trial. What will be the result? At the trial so directed every disputable issue will have been foreclosed to the Plaintiff in Error by the judgment against it in the equity suit. The trial will consist in substance solely in introducing the judgment-roll in that suit. It is apparent that under these circumstances any reversal of the judgment under review will be futile. The very matters which it is sought to review are already settled by an adjudication between the parties, so that there can be but one result, reversal or no reversal, viz.: a judgment upon the notes in favor of the Defendants in Error and against the Plaintiff in Error.

We are so certain of the correctness of our position upon this point that it is with some hesitation that we burden the Court with a discussion of the evidence bearing upon the defenses set up by the Plaintiff in Error. We are unwilling, however, to allow the charge of fraud to go unanswered. An examination of the evidence will show, we believe, not merely that there is evidence sufficient to sustain the findings of the Master that there was no fraud, but that there is no evidence to support the charge, and that the charge is made without warrant or justification. We accordingly proceed to a discussion of the charge of fraud and the other matters incidental to it.

III.

Defense of Fraud.

Counsel for the Plaintiff in Error devote much space in their brief and cite many authorities to show that fraud is nothing new in this world; that it assumes as many and as varied shapes as are capable of conception by the human mind; that it does not stalk forth openly in the bright light of day, but proceeds in secrecy and cloaks itself with forms and semblances, and that frequently, if not usually, it cannot be proven by direct evidence as to what was in the parties' minds, but only by the inferences which follow from all the facts and circumstances leading up to and surrounding and constituting the transaction under examination. Counsel need not have fought so stoutly for these supposed contentions. They are not contentions at all. We concede them. We always have conceded them. They are elementary. It is because of them that in this case there was permitted without objection, the widest and most searching examination by the Standard Corporation's counsel into everything and anything that might by any possibility throw light upon the subject. The relations between the persons involved, their private and confidential correspondence, the histories of the various companies, were all spread out before the court at the greatest length, although ninety-nine per cent of the evidence was wholly inconsequential. But if there was anything to be found anywhere in it that would indicate any

wrongful act or intent either on the part of the payees of the notes or on the part of those who represented them, the Plaintiff in Error was entitled to have it brought to light.

On the other hand, if after all this close and extended examination nothing inconsistent with good faith on the part of the payees and their agent Howard is discovered and the claim of fraud is found to be based only on strained and fanciful inferences, drawn from facts innocent and commonplace when viewed naturally, the conclusion becomes overwhelming that there was no fraud. That is exactly the situation here. The cry of fraud is chiefly directed at Howard. If there was any fraud on the side of the payees of the notes, Howard was a party to it. He was subjected to a most lengthy and searching examination. It was not an examination where counsel were groping blindly, or where the testimony of the witness could not be checked if untrue. Counsel had as a guide and as a means of checking any statement of the witness a mass of contemporaneous correspondence covering nearly every phase of the case. This correspondence was confidential in character and very evidently written without any idea of its ever being disclosed or used. Its truthfulness is stamped all over it. Yet under these circumstances, the testimony of Howard and the correspondence are consistent in themselves and with each other and both are plain and straightforward. Howard's testimony and the correspondence are likewise consistent with and supported by the testimony of

the other principal actors in the drama, Mr. Smith and Mr. Evans, one a lawyer, and the other a business man, both men of repute and position. The testimony of these three and the statements in the correspondence are not contradicted by any testimony on the part of the Plaintiff in Error. Its principal witness was Mr. Young, its secretary, but an examination of his testimony will not disclose any conflict with that of the three gentlemen named. What, then, is the tale that the record unfolds? It is substantially this:

In 1902 the Standard Portland Cement Company, a company distinct from the Plaintiff in Error, the Standard Portland Cement Corporation subsequently organized, was formed to engage in the manufacture of Portland cement at Napa Junction in this State. It was managed and controlled by the defendants Dingee and Bachman, of whom, it is evident enough, Dingee was the dominating personality. (Tr., pp. 264, 269, 270, 271, 135, 330, 693-696.)

In 1903 the Western Fuel Company, of which Mr. Howard was and is the president and managing officer, and which was engaged, among other things, in the business of marketing building materials, handled some of the output of the Standard Company as sales agent. Its agency in this year was not exclusive, but it became so in the following year, 1904. (Tr., p. 230.)

The contract covering the agency at this time does not seem to be in evidence, but this fact is immaterial, as the contract was superseded by another, which is in evidence.

The Standard Company was a great success (Tr. pp. 128), and its success induced Dingee and Bachman to organize and promote the Santa Cruz Portland Cement Company, for the purpose of manufacturing cement at a point near Santa Cruz. On March first, 1906, in anticipation of the early completion of the Santa Cruz plant, a contract was made between that company and Western Fuel Company, whereby the latter was made sales agent for the former. In consideration of the Western Fuel Company getting this agency it was agreed that its commission on sales for both cement companies should be ten cents a barrel instead of fifteen cents as provided by the then existing contract with the Standard Company. Accordingly, at the same time with the making of the contract with the Santa Cruz Company, a new contract was made with the Standard providing for this change in the rate of commission. (Tr., pp. 230, 263.) These two contracts appear on pages 249-252 and 259-262 of the transcript. They provide for an exclusive agency and a commission to the agent of ten cents per barrel. On the other hand, the agent itself is to pay each month for all deliveries during the preceding month, regardless of whether it has collected from the purchaser, or ever does collect. The effect of the contracts was to give the cement companies an active and aggressive selling agency, already established in business, and also to assure them of regular and sure payments for all sales, a feature of great importance to any manufacturing company whose pay

rolls and other operating expenses call for large amounts which must be met regularly and with the utmost promptness. The contracts further reserved to the manufacturing company the vital right of fixing the sale price, a right which gave them practical control of the situation as between themselves and the agent. These contracts continued in existence until the fall of 1908, some time after the making of the notes in suit.

In 1906 the Western Building Material Company was organized, for the purpose of taking over the portion of the business of the Western Fuel Company that was concerned with the handling of building material. Mr. Howard was and is its president. All of its stock was and is owned by the Western Fuel Company, and it is nothing more than an instrumentality of that company for the handling of one branch of its business. (Tr., p. 230.)

In furtherance of the purpose for which the Western Building Material Company was formed, the agency contracts with the cement companies were assigned to it by the Western Fuel Company on June 30, 1906, and it became the sales agent for those companies. (Tr., pp. 244, 253, 254.)

It may be well to make mention at this point of an understanding which the cement companies insisted upon as a condition to the execution of the sales contracts of March 1, 1906. This condition was that the cement companies should have the right to terminate

the agency if at any time Mr. Howard should cease to be the chief executive officer of the agency company. Counsel for defendant have laid some stress on this condition as indicating something sinister, and we mention it for that reason alone, for it has no other bearing. The explanation of how this condition came to be required by the cement companies is found on pages 562-564 of the transcript. It is simply that the officers of the cement companies had personal objections to the officer of the agency company next in rank to Mr. Howard.

The Standard Company was, as we have said, a great success. Mr. Howard, who made frequent visits to the northwest in connection with his coal business, suggested to Dingee and Bachman from time to time that there was a field on Puget Sound as yet unoccupied for another enterprise of the same sort and that this enterprise would not only be profitable in itself, but would also be advantageous to the California enterprises, since if Dingee and Bachman did not occupy the field others would certainly do so, and if they did they were also quite certain to invade the California markets with their product. (Tr., p. 272.)

Pursuant to these suggestions, Dingee and Bachman, in 1906, told Howard that if he could find in the neighborhood of the Sound suitable deposits of raw material they were favorably disposed to the putting up of a cement plant. It was also understood between them that if this were done Howard's company should have

the selling agency for the new concern and he himself should have some share in the promotion profits. (Tr., pp. 132, 133.)

Howard did various things toward finding suitable deposits about the Sound, and among other things he enlisted the assistance of Mr. Ernest E. Evans, of the merchant firm of Evans, Coleman & Evans, of Vancouver, who were the Vancouver agents for the Western Fuel Company, and are the Defendants in Error here. Mr. Evans, in June, 1906, introduced to Mr. Howard a man named Ridley, who claimed to have found some valuable lime deposits near Kendall on the line of the Bellingham Bay and British Columbia R. R. in the State of Washington, and Howard, Evans and Ridley went to look at the deposit. (Tr., pp. 131, 273.)

On returning to Vancouver Howard wired Dingee that he had found a lime deposit and for Bachman, who was the technical man of the two, to come up and see it. Bachman did so and at once authorized Howard to take up the option on the Ridley lands and also to secure other adjoining lands. (Tr., pp. 131, 273, 331.) Mr. Howard proceeded with the securing of these lands, and considerable of his testimony and correspondence was concerned with his difficulties in so doing. In addition to looking over the securing of the lands, Mr. Howard, because of his frequent visits to the northwest, at first looked after anything else there that required attention, such as the matters of freight rates, power, fuel, water supply, etc. These activities of his

ended in the spring of 1907, when Dingee and Bachman sent Mr. Davis to Kendall to superintend the erection of the plant. (Tr., p. 153.) After that time Mr. Howard did practically nothing in the affairs of the Kendall project. (Tr., p. 275.)

For the purpose of carrying on the enterprise at Kendall, Dingee and Bachman formed the Northwestern Portland Cement Company. (Tr., p. 759.) This was done toward the end of August, 1906. (Tr., pp. 639-642.) Mr. Dingee and Mr. Bachman immediately proceeded with the steps necessary to authorize the issuance of bonds of the Northwestern Company. These steps were completed and about January, 1907, the company began to issue bonds. They were avowedly issued for the purpose of raising money with which to construct the company's plant. (Tr., pp. 143, 155, 156, 157, 192.) With each bond sold by the company there went to the purchaser an equivalent amount in par value of its stock. This was commonly called bonus stock as if it were a gratuity, although legally of course it was a part of the sale just as much as the bonds.

Among the purchasers of the bonds in the new company were a number of friends of Mr. Howard, including Mr. Evans, who made their purchases through him. The Western Building Material Company also purchased nineteen bonds. Including the bonds of the Western Building Material Company there were purchased altogether through Mr. Howard one hundred bonds, of the par value of one hundred thousand dol-

lars. The purchasers of these bonds paid for them in cash at par. They also received, of course, their quota of the so-called bonus stock.

The stock of the Northwestern Company other than the bonus stock was retained by Dingee and Bachman as promoters' profits, and is usually referred to as promotion stock.

As we have said, Dingee had previously told Howard that, in consideration of his interesting himself in the enterprise, finding the deposits, etc., he should share in the promotion stock. At one time Bachman, in Dingee's absence, attempted to make an arrangement with Howard whereby the latter should share in the promotion stock equally with the others only in case he secured bond subscriptions to the amount of three hundred thousand dollars. Counsel for the Plaintiff in Error seem to attach some weight to this incident. We have never been able to see its bearing. In any case, the final result was that on the one hand Howard did not secure subscriptions for three hundred thousand dollars of bonds, and on the other hand Dingee and Bachman did issue to him an equal share of the promotion stock, namely, some nine thousand shares. (Tr., pp. 283-287.) This stock, of course, did not represent any actual investment, and its value was wholly prospective. Out of the amount he so received Mr. Howard gave to each one of those who had purchased bonds through him an amount equal in par value to the bonds purchased. Thus each purchaser through Mr. Howard

received through him and through the bonus stock an amount of stock equal in par value to twice the amount of the bonds he purchased. Mr. Howard made this contribution out of the promotion stock which came to him because it had originally been represented to those contemplating the purchase of bonds that the bonus stock would be issued on the basis of two for one instead of one for one as was finally done. (Tr., pp. 196, 305, 306.)

Mr. Howard also gave Mr. Evans a very considerable amount out of his promotion stock, in consideration of Mr. Evans' services in connection with the enterprise, and also prevailed on Mr. Dingee to make some contribution to Mr. Evans. (Tr., pp. 196, 197, 305, 306, 520.)

The foregoing covers the activities of Mr. Howard in connection with the Northwestern Company. For an exact appreciation of his relations to that company and to the other individuals interested in it, it is necessary to consider the things he did not do as well as those he did do. Mr. Howard had nothing whatever to do with the organization of the company (Tr., pp, 281, 282, 302), the making of its bond issue (Tr., pp. 281, 282, 302), its financial policy or its general management. (Tr., pp. 312, 557, 558, 565.) He was not one of those in control. He was not a stockholder until his promotion stock was given him. (Tr., pp. 329, 556.) He was never a director or officer. (Tr., pp. 333, 565, 672.) He never attended any meeting either of its di-

rectors or its stockholders. (Tr., pp. 302, 333.) His activities were confined to suggesting to Dingee and Bachman the establishment of a plant on Puget Sound, to finding a deposit of the raw material there, to attending to securing title to the lands, to looking after details on his visits to the Sound during 1906 and the early part of 1907, and to arranging for the purchase by various parties of one hundred bonds. This was all. In the real management, direction and control of the company he was not a factor. Dingee and Bachman were the responsible heads of the Northwestern, as they were of the other cement companies. It is very evident from the correspondence that it was they who directed the company and exercised final authority concerning it. Whatever Howard did he did under authority from them. Whatever information he had as to the intentions and plans of the company he received from them. As evidencing this, see the letters appearing on the following pages of the transcript, viz.: 383, 398, 405, 408, 411, 414, 415, 418, 445, 448, 459, 464, 466, 488, 491, 500, 509, 512, 516, 523; see, also, Tr., pp. 281, 302, 331.

This statement of the negative side of Mr. Howard's relations to the Northwestern Company is confirmed by his ignorance of the affairs of that company from time to time. Until informed by Mr. Evans he was ignorant of the failure of the company to pay its laborers in January, 1908. (Tr., pp. 181, 313, 535.) Until informed by the Wenzelburger report he was ignorant as to the financial condition of the company and the di-

version of its funds to the use of Dingee's California companies. (Tr., pp. 565, 566.) It was not until after Dingee's collapse in November, 1908, when he saw a statement of the Santa Cruz Company, that he became aware that the Bellingham Bay and B. C. stock owned by the Northwestern Company had been pledged to secure an indebtedness of the Santa Cruz Company. (Tr., pp. 566, 310-312.)

While we are discussing Mr. Howard's relations to the Northwestern Company it may be well to speak of his relations to the other two cement companies. His only substantial relation to those companies, or in fact to Dingee, was through the sale contracts mentioned. He was never an officer of either company or identified with them.

To resume the chronological history. In February, 1907, after the Northwestern Company was launched, the Plaintiff in Error, Standard Portland Cement *Corporation,* as distinguished from the Standard Portland Cement *Company,* was organized. It took over all the properties and liabilities of the Company and the latter became defunct. The object of the formation of the Corporation was not only to put into it the business of the Company, but, in time, to put into it the Santa Cruz and Kendall plants, thus consolidating the three Dingee-Bachman cement companies into one, which one was to be the Plaintiff in Error. Dingee and Bachman declared this to be their intention (Tr., pp. 221, 222, 281, 558), and the extremely broad powers set forth in the

corporation's Articles of Incorporation indicate the same thing. (Tr., pp. 666-671.) For instance, two sections of those articles are as follows:

> "(7) To acquire by purchase, subscription or otherwise, and to hold, own, deal in, sell, assign, transfer, mortgage, pledge, and otherwise dispose of shares of the capital stock of, and any bonds or other evidences of indebtedness secured or unsecured, granted or issued by any other corporation, or corporations, of this or any other State, Territory, or country, and to exercise all rights and powers of ownership, including the right to vote thereon;"
>
> "(10) To aid in any manner any corporation of which any of the bonds or other securities or evidences of indebtedness or stock are held by this corporation, and to do any acts or things designed to protect, preserve, improve or enhance the value of any such bonds or securities or evidences of indebtedness or stock;"

In the early part of 1907 the Northwestern Company purchased a considerable block of the stock of the Bellingham Bay and British Columbia Railroad. (Tr., pp. 317-324, 487.) Mr. Dingee, as executor or administrator of some estate (we believe the estate of Hayward), already held a block of the stock, and the purchase by the Northwestern Company gave him control. The railroad of the company ran from Bellingham Bay on the Sound to and through Kendall. The western half of the road paid and the eastern half did not. There were two objects in the Northwestern Company purchasing the stock and thereby securing a friendly control of the railroad. In the first place the establishment of a five thousand barrel cement plant at Kendall

would change the character of the east half of the railroad from a non-productive to a productive property, so as to make it an attractive buy to a larger road. It was desired that the Northwestern Company should get some portion of the increased value which would be so created. In the second place, and more important, the only outlet from Kendall to the cement markets was by this railroad. It was of the utmost importance that it have reasonable rates over the road and one way (and so far as yet discovered, the most effective way) to secure rates which would be reasonable, at least from the point of view of the cement company, was to purchase control of the railroad company. (Tr., pp. 318, 319, 873.) At the time of the Wenzelburger report, of which we will speak later, the Northwestern's books showed the railroad stock as having cost up to that time some $91,000.

In the early part of 1907 (Tr., p. 579), the Northwestern Company commenced work at Kendall, sending there Mr. Davis, with workmen and tools, for the purpose of clearing the ground and getting everything ready for the installation of machinery. The work progressed slowly and never got beyond the preparatory stage of constructing a track from the railroad to the mill site, clearing the land, erecting buildings for the accommodation of the workmen, etc. (Tr., pp. 135, 136, 586.) Both Evans and Howard became much dissatisfied with the slowness of the work. Evans would complain to Howard and Howard would complain to Dingee. (Tr., pp. 154, 155, 156, 158, 159, 316, 317,

506, 513, 515, 524, 525, 559, 807, 870, 872.) When the panic of 1907 came in November of that year, the workmen at Kendall were laid off. It was given out that the cessation of activities was merely temporary until the violence of the panic had passed, and Mr. Davis, the Superintendent, remained on the ground, and none of the supplies, equipment, tools, etc., were removed. But the dissatisfaction of Howard and Evans kept growing, and in December, 1907, it came to a head when it became evident that, although the Northwestern was the first cement company to be projected on the Sound, two other companies would have their plants in operation in that field before it. On December 11, 1907, (Tr., p. 527), Evans writes Howard that it looks to him as if Dingee had missed his opportunity and that he, Evans, wishes his money were not in the scheme and inquires if there is any objection to his writing the secretary for information about the company. Howard replies on December 16th (page 529 of Transcript) that he agrees with Evans and that Dingee and Bachman have missed the golden opportunity at Kendall and suggests that, instead of writing to the secretary of the company for information, Mr. Evans write Dingee himself. Howard also says that what he wants to lead up to is the repurchase of all the bonds that went through his hands so as to get his friends out. Evans answers on December 20, 1907 (page 530 of Transcript), that he is writing Dingee as Howard suggests, that he feels very sore, and that if they could get their money back

it would be the best thing. Howard answers December 26, 1907 (page 531 of Transcript), saying *inter alia* that he has learned that negotiations are under way for the sale of the Bellingham Bay and British Columbia Railroad and that in case the sale went through he would urge the repurchase of the Northwestern bonds with the proceeds so obtained.

Evans wrote Mr. Dingee, as he stated to Howard he would do, and received no reply, and on January 6, 1908, he wrote Mr. Dingee again. (Tr., pp. 159-162, 532.) To this inquiry likewise Mr. Dingee made no reply.

On the same day that Evans made his second inquiry of Dingee he learned that the Northwestern Company had not paid its laborers in Kendall for two months and that they were in serious want and threatening to file liens, etc. He immediately wires Mr. Howard and is advised by the latter's office that Howard is on his way north, but that a copy of his wire has been sent to Mr. Dingee, who has promised settlement by the fifteenth of the month. This Evans writes to Howard at Nanaimo. (Tr., pp. 163, 165, 533.) Howard replies from Nanaimo (Tr., p. 534) that he did not know that things had come to such a pass at Kendall, that it was wrong, and that there was not the investment at Kendall to represent the amount Dingee had received by the sale of bonds, and that means would be taken to ascertain what he had received and what disposition had been made of it.

On January 30, 1908, Howard has returned to San Francisco and he wires Evans to know if he has heard from Dingee. Evans replies that he has not. (Tr., p. 537.) Howard thereupon writes Dingee requesting him to give Evans the information the latter has asked (Tr., p. 540), and also writes Evans sending him a copy of his letter to Dingee, and requesting Evans, in case he does not hear from Dingee, to send him some Northwestern shares for the purpose of having them transferred into the name of some accountant to enable him to make an examination of the company's books. (Tr., p. 538.) Howard had previously in talk with Evans in the north advised him to do this if he got no satisfaction from Dingee. (Tr., pp. 178, 202, 203.)

Evans promptly sent the shares to Howard and they were transferred to the name of Wenzelburger, a public accountant, who made the desired examination. The results of the examination were set forth in a written report, which was put in Mr. Howard's hands at the end of February, 1908, and which was immediately transmitted to Mr. Evans. (Tr., pp. 181, 187, 549.)

This report disclosed to Howard and Evans for the first time something of the true inwardness of the Northwestern Company's financial management. (Tr., pp. 192, 549, 565.) A copy of the report is attached to the end of Mr. Evans' deposition. It showed that in all 295 bonds had been sold; of these, however, eleven had not been paid for. They were in fact never paid for and were never delivered, leaving as the actual num-

ber of bonds sold 284. On these was realized $284,000. This constituted all the cash received by the Company, and the report showed that of it $9,486.07 had been diverted to Dingee personally, $7,150 had been diverted to the Plaintiff in Error, the Standard Corporation, and $105,168.33 had been diverted to the Plaintiff in Error's sister corporation, the Santa Cruz Company. The balance of the money had apparently been expended legitimately. In other words, it became apparent that Dingee, or Dingee and Bachman, had taken the funds of the Northwestern to help out their two California enterprises to the extent of something over one hundred and ten thousand dollars.

It was the sort of report that would naturally stir an investigating bondholder to action. It did so. Howard, when he sent the report to Evans, was leaving for New York and Washington, D. C., to endeavor to secure a contract for the sale of cement to the Panama Commission. Evans, on March 4, 1908, writes to him at New York (Tr., p. 549), that he has received Wenzelburger's report and that his suspicions are more than confirmed that Dingee and Bachman have been using the money for their personal ends, that according to the laws of British Columbia they are criminally liable, and if they were in British Columbia would be compelled to make good within forty-eight hours or be arrested. Mr. Evans also states that he will go to California about the middle of the month and will await Mr. Howard's return from the East.

This letter was apparently sent by Mr. Howard from New York to Dingee. There is no written evidence of this and Mr. Howard has no recollection of it (Tr., p. 962), but Mr. Young's testimony is quite positive that he saw such a letter from Evans in Dingee's hands. (Tr., p. 722.) Much has been said about the threats of criminal prosecution made against Dingee and about they being an inducement for him to enter into a fraudulent conspiracy to relieve himself of the people making the threats. The letter just mentioned is worthy of note as it is absolutely the sole and single instance of any mention to Dingee of criminal responsibility on his part.

Mr. Evans was delayed in coming to San Francisco by the illness of his brother, but finally came toward the end of March. (Tr., p. 203.) Mr. Howard had returned and immediately on Evans' arrival the purchase of the Northwestern bonds by the Standard Corporation was arranged. There are three witnesses, Evans, Howard and Smith, who testify to the various interviews and acts which resulted in the arrangement. The testimony of Mr. Evans is on pages 187 to 195 and 203 to 210 of the Transcript. Mr. Howard's account appears on pages 575, 576, 962-966 of the Transcript; Mr. Smith's account appears on pages 967-976 of the Transcript. Those three accounts are all to the same effect. The differences between them are unimportant and such as one would expect to find after the years which have elapsed.

The interviews and acts which resulted in the arrangement for the purchase of the Northwestern bonds and the issuance of the notes of the Plaintiff in Error are, of course, the crux of the latter's case. If there was fraud, it must have been here. We propose to set forth these interviews and acts in some detail, and we submit that everything that was said and done by Howard and the bondholders is not only consistent with good faith on their part, but was the natural thing for them to do, the very thing that any one of us, court and counsel included, would ourselves have done under the same circumstances, without the slightest idea that we were doing anything wrong. What took place was substantially this:

When Mr. Evans reached San Francisco he called on Mr. Howard early in the morning, and found him busy. He then called on Mr. Smith, both because he was an attorney and because he was a bondholder of the Northwestern like himself. Smith and Evans talked the matter over and arranged to get hold of Mr. George C. Spencer, another bondholder, and the three then called on Mr. Howard. The matter was discussed and Howard, as the man through whom the bonds had been bought and who knew Dingee best, was asked to see him and find out what he proposed doing about going on with work at Kendall or taking up the bonds.

Howard went to see Dingee the same day (March 26, 1908), and Dingee told him that they intended going on with the work, but that it was advisable, in view of

the financial situation, not to press construction then, that if Mr. Howard's friends were uneasy he would arrange to buy their bonds, that he could not pay for them himself, but he could arrange for either the Standard or the Santa Cruz to buy them, paying for them with notes. Howard's interview with Dingee was short and Dingee's answer was given promptly upon Howard's stating the purpose of his call. Howard reported back to Evans, Smith and Spencer, and then wrote Dingee the following letter: (Tr., p. 879.)

"March 27, 1908.

"W. J. DINGEE, ESQ.,
San Francisco, Cal.

"Dear Mr. Dingee:

"Referring to our interview of yesterday A. M., I have seen several of the Northwestern Cement Co. bondholders.

"Told them that upon the surrender of their bonds with the 100% bonus stock you were willing to give them one year notes of Santa Cruz Portland Cement Co. or Standard Portland Cement Corporation, bearing interest at 6% payable semi-annually, as is the case with the bonds they held.

"They then asked—

"1. Have either of these two companies the right under their articles of incorporation to purchase and to hold the stock and bonds of other corporations?

"I told them I felt sure that your articles were drawn with broad enough powers to enable them to do this, but that you could satisfy them on this point.

"2. Would you furnish copy of the resolution of the board authorizing the purchase of the bonds?

"I said that I thought there would be no objection to that.

"3. Would you endorse the notes of the company that you purchased?

"I said that I had not raised that point and only you could answer.

"My belief is that they would prefer the Standard Company's notes. Yours truly,

"JLH/G *President.*"

No reply apparently was made to this letter, but Howard saw Dingee again and, in accordance with the decision of Evans, Smith and Spencer, told him that the bondholders would take the notes of the Standard, it being also understood that Dingee would endorse the notes and that the purchase would be authorized by resolution of the Standard's board of directors. The bondholders were also furnished with a copy of the Standard's articles of incorporation, for the purpose of seeing whether it had power to purchase the bonds and stocks of another corporation. It was found that such purchase was expressly permitted.

The matter being arranged, Evans requested Howard to write him a letter setting out the arrangement, so that he could send it on to Mr. Rand and the two Warner brothers, who had taken some of the bonds originally purchased by Evans, Coleman & Evans. Accordingly Howard, on the next day, wrote Evans as follows: (Tr., p. 165.)

"After conference with some of the subscribers of bonds of the Northwestern Portland Cement Company, I have arranged that the Standard Cement Corporation will take up the bonds that were subscribed for through

the writer, and that corporation will issue in payment its notes for the face value of the bonds, payable on or before one year with interest at six per cent payable semi-annually.

"Will you, therefore, please send me your bonds and all the shares, and I will give you receipt therefor, until I deliver you the note as stated.

"The Standard Portland Cement Corporation has authority by its articles of incorporation to buy and own securities in other corporations.

"Its board of directors will authorize this step, and I shall be furnished with a certified copy of authority to purchase. Mr. W. J. Dingee will endorse these notes."

Howard also wrote the same letter to other bondholders of the Northwestern who had purchased their holdings through him. (Tr., p. 880.)

The next thing is a letter from Mr. Howard to a Mr. Stockett at Nanaimo, who had likewise purchased bonds through Howard, informing Stockett of the arrangement for the purchase of the bonds and requesting him to send his bonds down.

On April 9, 1908, Howard writes Dingee as follows: (Tr., pp. 882, 883.)

"April 9, 1908.

"W. J. DINGEE, ESQ.,
Crocker Building,
City.

"Dear Sir:

"Referring to our recent conversation about the Northwestern bonds, I enclose forms of resolution and note. Please tell me if the form of note is acceptable, and if the resolution is O. K. will you kindly have it passed and send me certified copy.

"I will then prepare note to accompany each batch of securities. Yours truly,"

The forms of resolution and note which accompanied this letter were made in Mr. Howard's office from pencil drafts prepared by Mr. Sidney V. Smith, and read as follows: (Tr., pp. 909, 910.)

"SAN FRANCISCO, ..., 1908.

"For value received the Standard Portland Cement Corporation promises to pay to the order of .... on or before one year from May first, 1908, the sum of ..... Dollars, with interest thereon from said day until paid at the rate of six per cent per annum payable semi-annually, and if not so paid to be compounded.

"STANDARD PORTLAND CEMENT CORPORATION.

By .....Pres't.

.....Secty.

(over)

"For value received, I hereby waive presentment, demand, protest and notice of nonpayment of within note."

"*Resolved:* That the President be, and he is hereby authorized and directed to buy bonds of the Northwestern Portland Cement Company and the shares of the stock of said Company which have been issued to the holders of said bonds in the proportion of one share of such stock for every One Hundred Dollars of the amount of such bonds, and in payment therefor to give to each person from whom such bonds and shares shall be bought, the note of this Company executed by the President and Secretary under the corporate seal, payable on or before one year from May 1st, 1908, for the amount of such bonds so purchased, bearing interest at the rate of six per cent per annum from said date until

paid, payable semi-annually, and to be compounded if not so paid."

To the letter of April 9, 1908, Mr. Dingee replied the next day as follows: (Tr., p. 726.)

"JOHN L. HOWARD, ESQ.,
City.

"Dear Mr. Howard:

"Your favor of the 9th inst., enclosing form of note to be given in the matter of the purchase of the Standard Portland Cement Corp. of bonds and stock of the Northwestern Portland Cement Co., also copy of resolution is received. The form of note is, of course, satisfactory, but as to the resolution, would it not be better to have resolution with each purchase, and if not, to limit the resolution to the purchase of so many?

"Mr. Young, the Secretary, has gone to Placerville, but will be here Monday, when we can take up the matter and close it up the first of the week.

Yours truly,

WILLIAM J. DINGEE."

This is the last communication between Howard and Dingee concerning the matter. Thereafter it was left to the secretaries of the Western Fuel Company and the Standard to attend to the details of the consummation of the transaction.

Now if the theory of the defendant is correct and the proposed purchase by the Standard was really a sham clothed by resolutions and formalities in the garb of a genuine and honest transaction, the resolutions and formalities discussed in these last two letters are the ones that were arranged to accomplish the fraudulent purpose; but we say that these letters—natural, informal

and unstudied as they are,—are in themselves evidence that such is not the case. Men in conspiring do not write such letters. In fact they do not write letters at all where they are in easy personal reach of each other, as in this case.

The secretaries of the two companies completed the transaction as planned. Mr. Norcross, secretary of the Western Fuel Company, gathered together all but ten of the bonds sold through Mr. Howard, together with the accompanying stock, and on May 4, 1908, he wrote the Plaintiff in Error as follows: (Tr., pp. 730-733.)

"May 4, 1908.

"STANDARD PORTLAND CEMENT CORPORATION,
Crocker Building, City.

"*Dear Sirs:* Northwestern Portland Cement Company. In accordance with understanding between Mr. Dingee and Mr. Howard, I have prepared notes as listed below for execution by the Standard Portland Cement Corporation. These notes are to be endorsed by Mr. Dingee, and he is to waive notice of protest.

"Following are the notes dated May 1st, 1908, payable on or before one year from date with interest at six per cent per annum:

(In ink)	Charles D. Rand	$ 5,000.	
	Evans, Coleman & Evans..	30,000.	
	Sidney V. Smith	25,000.	
	Western Building Material Co.	19,000.	
	Catherine E. Spencer	3,000.	
	T. R. Stockett, Trustee ...	3,000.	
	Thomas Graham	1,000.	
	A. S. Hamilton	1,000.	
		$87,000.	
(In pencil)	D. M. McKay	3,000.	90,000.

"Please have these notes ready for delivery to me on Tuesday the 5th inst., when I will deliver you eighty-seven bonds of the Northwestern Portland Cement Company, numbered as follows:

Numbers 1, 2 & 3	.....	3
" 213 to 217 inc.	.....	5
" 7 to 50 inc.	.....	44
" 123 to 157 inc.	.....	35
		87
(in pencil) 4 5 & 6	.....	3
		90

"I will also deliver you the following stock certificates which have been endorsed:

Number.	*In Name of.*	*No. of Shares.*	
54	John L. Howard, Tr.	190	
72	Sidney V. Smith	250	
74 x 52 (52 in pencil)	Geo. W. Spencer	30	
125 x 53 (53 in pencil)	T. R. Stockett, Tr.	30	
126	Thomas Graham	10	
127	Jeannie Hamilton	10	
154	Charles D. Rand	10	
155	" " "	10	
156	" " "	10	
157	" " "	10	
158	" " "	10	
160	Ernest E. Evans	30	
179	" " "	50	
180	Adam L. Russell	70	
196	A. Wenzelburger	150	
	Total	870	
			870
73	McKay	250	30 (In pencil)
			900
(in pencil)		30	

"I will also deliver you certificate No. 188 in name of John L. Howard, Trustee. This I should like to have Mr. Dingee receipt for, as it is stock which he personally gave to Ernest E. Evans.

"I will also deliver you a deed for certain property which stands in the name of John L. Howard.

"For this Mr. Howard is to receive your note for Eighteen Hundred Dollars dated May 1st at six per cent, payable on or before one year.

"Will you please have a certified copy of the attached resolution made as arranged.

"The other thirteen bonds which make up the One Hundred Thousand Dollars subscribed through Mr. Howard are expected here in a few days, and will be presented as soon as received. Yours truly,

D. C. NORCROSS."

Within the next day or so, pursuant to the foregoing letter, Mr. Norcross called at the office of the Plaintiff in Error on Mr. Young, its secretary, and delivered to him the stocks and bonds, and received in return the Standard's notes. He also received the Standard's receipt for the stocks and bonds (Tr., pp. 745, 746), and a certified copy of the resolution of its board of directors authorizing the purchase of the bonds and the giving of the notes. (Tr., p. 734.) The certified copy of the resolution received by Mr. Norcross reads as follows: (Tr., pp. 736, 737.)

"THIS IS TO CERTIFY, that at a special meeting of the Board of Directors of the Standard Portland Cement Corporation, duly called and held on the 5th day of May, A. D. 1908, at which meeting a majority of said Board was present, the following resolution was unanimously adopted:

"*Resolved,* That the President or the Vice-President or either of the Vice-Presidents of this Corporation, be and he is hereby authorized and directed on behalf of this Corporation to buy One hundred (100) bonds of the Northwestern Portland Cement Company for One Hundred Thousand Dollars ($100,000), together with the shares of stock of said Company, which shares have heretofore been issued to the holders of said bonds in the proportion of one (1) share of stock for each and every hundred dollars of the amount of said bonds. And he is further authorized to give the obligation or the obligations of this Corporation in payment therefor to each person, or persons, from whom such bonds and shares shall be bought, which obligations shall be executed by him under the name of this Corporation and attested by the Secretary under the corporate seal, and shall be made payable on or before one (1) year after May 1st, 1908, and shall bear interest at the rate of six per cent (6%) per annum, from said date until paid; interest to be made payable semi-annually, and to be compounded if not so paid. He is further authorized when such obligation or obligations shall become due, and if then unpaid, to renew the same from time to time until the amount due is paid in full.

"IN WITNESS WHEREOF, the Secretary of said Standard Portland Cement Corporation has hereunto set his hand officially and affixed the seal of said Corporation, this 5th day of May, A. D. 1908.

(Signed) L. F. YOUNG,
Secretary, Standard Portland Cement Corporation."

We should have also mentioned the fact that it was understood that Mr. Howard would return the promotion stock which he had received, and a few days after the delivery of the bonds and the stock accompanying them Mr. Norcross gathered up all of Mr. Howard's

promotion stock, which had been somewhat scattered, and delivered it to Mr. Dingee.

With the occurrence of the events last mentioned the transaction involved in this action was consummated. If any fraud has been perpetrated on the Standard, it had then been accomplished. Yet where in all of this long history is there the slightest reason for even a suspicion of Howard and the bondholders? Their course has been perfectly plain and perfectly natural. It may be summed up in a few words. The bondholders became dissatisfied at the progress of the Northwestern's works and, proceeding to investigate, learned of the diversion of its funds to the uses of the Standard and the Santa Cruz. Through Mr. Howard, through whom they had made their investment, they went to the man in control of all three companies—Mr. Dingee—and asked him what he was going to do about it. He replied that he would arrange for either the Standard or the Santa Cruz, as they preferred, to buy with its notes their Northwestern bonds and stocks and relieve them of their investment. They replied that they preferred the notes of the Standard, and the transaction was put through. This is essentially all there is to it. We repeat again that anybody under the same circumstances would do exactly what Howard and the bondholders did, and would do it without any idea, no matter how scrupulous he might be, that he was doing anything wrong or in the slightest out of the way.

What, then, is it that is claimed to be wrong about

the matter? We think that all of the arguments and claims of counsel as to fraud may be boiled down to this one claim, namely, that the transaction in question was a foisting on to the Standard of worthless stocks and bonds in whose acquisition it had no interest. The reply to this claim is that it is not supported in any particular. The transaction was not a foisting; the bonds and stocks were not worthless; their acquisition was not a matter in which the Standard was not interested. The transaction was not a foisting, for the reason that Howard and the bondholders did nothing whatever that was fraudulent or wrong in order to induce the Standard to buy the stocks and bonds. They occupied no confidential relation toward the Standard and were under no duty to do it. They had a right to deal with it upon the same footing as with anybody else. They were guilty of no deceit or misleading, either by way of misrepresentation or by way of concealment, and they exerted no improper pressure. That being the case, and there being, as we have said, no confidential relation, there was no foisting, and the transaction was not impeachable, regardless of whether it was a good or bad bargain for the Plaintiff in Error.

The bonds and stocks were not worthless or nearly so. Considerable time was spent at the trial in going into the assets of the Northwestern Company and much has been said about the Northwestern being a bankrupt and defunct enterprise. It may be so now, but it was not so at the time of the purchase in question.

Throughout counsel's argument there is a constant shifting of the point of view from that time to the present. But at that time the completion of the Northwestern plant had not been wholly abandoned, and outside of its bonds the only indebtedness of the company was some $17,000. The construction engineer, Mr. Davis, remained on the ground with the tools and equipment necessary to the continuation of the work. The bondholders were assured that the cessation of active construction was merely temporary and due to the panic. So far as they were informed it was an enterprise whose active prosecution had temporarily ceased, but which it was planned to resume as soon as business conditions improved. If this were done and the plant completed, the bonds were good for their face value. Nor were Mr. Dingee's assurances to be taken lightly. His collapse did not take place until much later, and he was still regarded as a rich man, although one pressed for ready money. This was the opinion of Mr. Young, according to his own testimony, and Mr. Young was in a far better position to know what Mr. Dingee's actual financial condition was than Mr. Howard or any of the stockholders. (Tr., p. 751.)

In this connection the fact is quite significant that the bondholders wanted Dingee's endorsement on the notes. They did not ask for Bachman's and were surprised when they got it, but they did want Dingee's. (Tr., pp. 190, 879.) This would hardly have been true if Dingee had been considered as a broken man. Furthermore in

this connection the fact should not be lost sight of that while active operations had stopped at Kendall, Mr. Davis, the engineer in charge of construction, and the construction machinery and equipment, remained on the ground ready to start active work again at any time. Counsel for defendant say that the Kendall scheme was abandoned in the fall of 1907. This is not true. There is no evidence to support the statement and it affirmatively appears that Mr. Davis did not leave and the machinery and equipment were not removed until August and September, 1908. (Tr., pp. 587, 597.)

Nor were the bonds worthless in any view of the case. They are not worthless to-day, although their value is very much less than when the Standard purchased them. The correctness of the Wenzelburger report has not been questioned and it shows that, taking the amounts due from the Standard and Santa Cruz at their face (and certainly the bondholders of the Northwestern in making a sale to the Standard were justified in so taking the debts of it and its sister company), there would be practically no loss to the Northwestern if it resumed construction, and if it did not resume and all that had been expended were lost, yet its assets aggregated something between eighty and ninety per cent of the face of its bonds.

Taking the trial balance on the last page of the Wenzelburger report, we get the following as a correct statement of the assets and liabilities of the Northwestern Company:

STATEMENT OF THE ASSETS AND LIABILITIES OF THE NORTHWESTERN PORTLAND CEMENT COMPANY ACCORDING TO THE WENZELBURGER REPORT, OMITTING THE CAPITAL STOCK AND BONDS OF THE COMPANY.

ASSETS.

Lands etc. upon which there had been expended		$64,787.81
Under property account	$31,325.20	
" C. W. Howard account	500.	
" Construction accounts:		
Mill expense	996.13	
Expense	3,167.69	
Machinery	2,473.54	
Construction	11,521.95	
" buildings	7,106.88	
" railroad	7,452.04	
Engineering	244.38	
	$64,787.81	
Due from Bellingham Bay etc. R. R. Co. on account of purchase of rails $10,-365.95, less amount due that company for freight, $1239.05, or net		9,126.90
Stock of the Bellingham Bay etc. R. R. Co. costing		91,608.
Due from W. J. Dingee		9,486.07
Due from Standard Portland Cement Corporation		7,150.
Due from Santa Cruz Portland Cement Company		105,168.33
Cash		12.20
Total of assets upon which the outstanding bonds of the company amounting to $284,000. were a first lien		$287,339.31

LIABILITIES.

Interest		$ 2,233.42
Sundry accounts		3,325.89
Bellingham Bay Ind. Lumber Co.	$ 742.76	
Morse Hardware Co.	27.97	
Keuffel & Esser Co.	51.87	
The D. L. Haas Co.	93.50	
Crane Co.	1.50	
Cal. Powder Works	1,242.95	
Allis-Chalmers Co.	1,109.34	
Althof & Bahrs	56.	
	$3,325.89	
Santa Cruz Lime Co.		4,000.
Atlantic Portland Cement Co.		7,500.
Total liabilities, omitting stocks and bonds		$17,059.31

The foregoing statement omits as an asset $14,220 paid as interest, and the items of $5000, $2000 and $4000 due respectively from Bachman, McGary and Churchill, These latter sums were due on their subscriptions for bonds. On the other hand, the bonds so subscribed for had not been in fact delivered, and never were delivered, so that the amount of outstanding bonds is reduced by the same amount, that is from $295,000, as shown by the trial balance, to $284,000. We accordingly have as against $284,000 of bonds, some $287,339,31 in assets according to their book value. Against these assets there are liabilities aggregating only $17,059.31, and of this aggregate only $3,325.89 represents liabilities of such a nature as to give them

by any chance a preference over the lien of the bonds.

Nor is the book value of the assets out of the way. The largest single item is that of $105,168.33, due from the Santa Cruz Company. As we have said, Howard and the bondholders in dealing with the Standard were justified in considering this item as worth its face. They certainly would have been justified in so doing had they known what was the fact, that while the Santa Cruz owed the Northwestern $105,168.33, and the Standard owed the Northwestern only $7150, yet the Standard owed the Santa Cruz some $73,000. (See trial balances of Santa Cruz and Standard for April, 1908, appearing on pages 697 et seq. of Transcript). In other words, the Santa Cruz had $73,000 coming to it from the Standard which it could apply on its debt to the Northwestern, and if there had come a tri-partite settlement between the three the Santa Cruz would have had to pay the Northwestern only some $32,000, while the Standard would have had to pay it some $80,000—$7150 on its own account, and $73,000 on behalf of the Santa Cruz.

The next largest item is that of $91,608 for Bellingham Bay and B. C. stock. This stock had in fact been previously pledged to secure a debt of the Santa Cruz Company, but of this Howard and the bondholders were ignorant. (Tr., pp. 310-312, 566.) So far as they were concerned the stock was on hand.

A good deal has been said as to the poor condition of the railroad company. We do not desire to discuss

this question at length. Suffice it to say that while the statement from the company's books, put in evidence, shows practically no net earnings over and above the fixed charges, yet it shows that the earnings have been cut down on the books by writing off a large amount to depreciation, and the construction and equipment accounts show invested in the road very nearly one and a half million of dollars after deducting the floating indebtedness, while its bonded debt amounts to only some $659,000. (Tr., pp. 686, 692.) The point of the matter, however, is that as to the cement company the control of the railroad was, as we have said, of great importance. The stock had been purchased for the cement company by its officers in good faith and the bondholders of the cement company were certainly justified in considering the railroad stock as worth to the company fully what had been paid for it.

As to the items of $9,126.19 due from the railroad company, and $9,486.07 due from Dingee personally, these likewise the bondholders were justified as considering worth their face. The railroad company was certainly equal to the payment of so small an amount, and as for Dingee, he was, as we have said, still looked upon as a very rich man.

There remains only the item of $64,787.81, expended, and, so far as known, honestly expended, in the acquisition of lands at Kendall and in work on the lands. Evidence was introduced for the purpose of minimizing the value of these lands. The evidence was con-

fined to their value for purposes other than that of a cement plant. For any purpose but this it may well be said that they had but little value; but for this purpose they undoubtedly did have a very considerable value. They could probably be sold to-day for every cent of what they cost, which is the amount for which they are down on the company's books. The conclusive indication of their value, or at least of the fact that the bondholders considered them of value, and that after all is the point in this case, is the fact that Evans, who visited Kendall on several different occasions, was willing actually to invest his own money on his faith in these lands, that Howard was willing to permit his friends to invest in a scheme whose success depended entirely on these lands, and that Dingee and Bachman were ready to undertake the enterprise of establishing a mill upon the lands when the failure of the enterprise would surely hurt their reputations and credit as successful business men.

We submit, accordingly, that it must be taken that the lands were worth fully as much as the company paid for them, some $17,000.

As to the amount that had been expended in work on the lands, this would be almost wholly lost if the enterprise were permanently given up, but it would not be lost if work were resumed, and it should be always remembered that the bondholders were assured work would be resumed (Tr., pp. 188, 189, 191), and that if it were resumed it would be directly in the interest

of the Standard. The amounts so expended aggregate between forty and fifty thousand dollars.

The net result is that as against $284,000 of bonds that were a first lien and $3500 of preferred claims, there were assets that even in liquidation should have brought between two hundred and forty thousand and two hundred and fifty thousand dollars. This is the result of an analysis of the Wenzelburger report, and it is also the estimate Evans put upon them at the time. (Tr., pp. 193, 217-220.) On the other hand, if the company were not liquidated but work were resumed at Kendall, there would be practically no loss whatever. This is the way in which Mr. Evans looked at the matter, according to his positive testimony, and we say that there is nothing in the evidence that does not justify his doing so.

Likewise it is not true that the Standard had no interest in the purchase of the Northwestern bonds and stocks. The Northwestern plant had been projected in part for the protection of the California plants. One of the purposes for which the Standard Corporation had been formed was to take over both the Kendall and the Santa Cruz mills and thus combine the three Dingee-Bachman companies. This alone was interest enough to justify the purchase. It was interest enough to warrant the bondholders in considering a sale to the Standard as perfectly legitimate. The Standard of all concerned was the one fundamentally interested in the successful accomplishment of the enterprise represented

by the Northwestern Company. In this connection it must be remembered that if Dingee and Bachman went on with the Northwestern to the successful completion of its plant, the Standard would not lose by the purchase of the Northwestern stocks and bonds. Here is the answer to the question put by counsel in several different forms. If the bonds were valuable, why were the bondholders anxious to dispose of them? The answer is that their full value depended on the company going ahead, and upon this point the bondholders were much dissatisfied. They had Dingee's assurances that the work would be resumed as soon as business condition warranted, but they could not tell how genuine these assurances were and they had no very effective means of compelling their performance. The Standard, however, was in a very different position. It had an interest in the Northwestern's going ahead over and above a mere investment interest. Its management was the same and it would know whether or not Dingee's assurances were genuine, and it would also know that its interests would be considered in determining the course to be pursued regarding the northern company.

But over and above all this the Standard had the very strongest interest in making an arrangement with the Northwestern bondholders. What alternative was presented to it? If Evans and the bondholders acting with him were not settled with, they would certainly seek to enforce their legal rights. Either directly as stockholders in the Northwestern, or through the medium of

a receiver for that company, they would certainly proceed against the Standard and the Santa Cruz to compel them to repay the moneys illegally diverted to them. A further investigation into Northwestern affairs was certain to disclose the as yet unknown pledge of the Bellingham Bay and British Columbia Railroad stock to secure a debt of the Santa Cruz Company, and suit would be brought on that ground as well. The bondholders would have had a perfect right to bring these suits. They were supported by genuine causes of action. But the mere bringing of them would have been disastrous to both the cement companies. Their credit was not strong as it was. Such suits would have ruined them. The Standard perhaps might have easily paid the sum owing by it to the Northwestern—some $7150—but not so the Santa Cruz. For moneys diverted and stock pledged it owed—and to this day it owes—to the Northwestern something over two hundred thousand dollars. This in the spring of 1908 it could not hope to pay without securing time, and considerable time. The point of the matter is that the Standard was vitally interested in seeing that the Santa Cruz got this time.

For one thing the Standard owned $211,000 of the bonds of the Santa Cruz. (Tr., p. 754.) This investment it was interested to protect, and was by section 10 of its articles of incorporation specially authorized to protect. For another thing, it itself, as we have said, owed the Santa Cruz some $73,000, and if the Santa Cruz were called on to pay the Northwestern, the

Standard was certain to be called on to help to the extent of this $73,000. For this it would itself require time.

For another thing, the failure of the Santa Cruz meant the failure of the Standard. The two companies were too closely linked for one to go down without the other going with it. When they finally did go under, in November, 1908, they went together.

But the fact that it was vital to the Standard to secure a settlement with the dissatisfied bondholders of the Northwestern is made most clear when we consider the revelations that would have been made by the bondholders' suits. Those suits would have disclosed instantly the financial weakness of both the Standard and the Santa Cruz, and that their managers had endeavored to bolster up both companies by illegally diverting to their assistance moneys and property of another company of which they had control. Neither company could have endured such disclosures to the banking and business community.

There is a good deal of talk in this case about the pressure exercised on Dingee to make him take up the bonds. Now, as a matter of fact, the bondholders did not seek to put any pressure on Dingee. They did not threaten him with either civil or criminal prosecution. Except for the incident of Howard sending him Evans' letter of March 4, 1908, the matter of his civil or criminal responsibility was not mentioned to him, nor were the disclosures of the Wenzelburger report discussed

with him. (Tr., pp. 124, 560.) The bondholders merely sent Howard to see Dingee to ask what he proposed to do. But supose the bondholders had gone very much further—suppose they had gone to Mr. Dingee and said to him, "See here, you have taken our money which we invested in the Northwestern securities and diverted it to the needs of your two California companies. Now you make a satisfactory settlement with us. You have one of those companies relieve us of our Northwestern investments or we will immediately commence legal proceedings against them and you to recover the diverted moneys"—would there have been anything wrong in such a demand? The bondholders had a perfect right to commence legal proceedings and, as a condition of giving up this right, they had the right to demand of a company which had benefited by the diversion of their moneys that it relieve them of their investment. If the demand would not have been wrong, there would have been nothing wrong in their accepting a compliance with their demand. Now in this case no demand was made and there was no threat or attempt at pressure, but the fact that, if the Northwestern bondholders had threatened Mr. Dingee with suit against him and his companions it would not have been wrong, emphasizes strongly the propriety and legality of the settlement that was actually made.

In this connection we would speak of the contention so frequently advanced, that because the sales agency contracts were exclusive and the cement companies

marketed all their product through Howard's company and received payments therefor through the same channel, Dingee and his companies were subject to pressure by Howard through their fear of his cutting off their funds. But if Howard's company at any time had refused wrongfully to account and to pay to the cement companies what was due them they could have immediately terminated the agency. Furthermore, and more important, it appears both by Mr. Howard's testimony and Mr. Young's that there was never any attempt to shut off funds from the cement companies, or by this means to bring pressure to bear upon them. On the contrary, the evidence is that the Western Fuel Company and the Western Building Material Company made their payments with the utmost promptness, much to the advantage of the cement companies. The only instance in which the agency company held back money was that arising out of the failure of the Standard and the Santa Cruz to attend to the bills of the Western Building Material Company for deficient cement and returned bags. The dispute about this was settled at the end of February, 1908, and from that time on, and during the very time of the transaction in question here, Howard's company made its payments with the utmost promptness. Mr. Young himself admits this. (Tr. pp. 729, 730.) There was accordingly no pressure exercised upon Mr. Dingee in this respect.

It may be well at this point to speak of the matter of the drafts or bills which were drawn by the cement

companies on the Western Building Material Company and accepted by the latter. By the sales contracts the Western Building Material Company was required on the 14th and 28th of each month to pay for all cement delivered during the preceding month, one-half being payable on each date. During the year 1908 the Western Building Material Company permitted the cement companies to draw upon it against deliveries in advance of the day of payment, and it would accept these drafts, agreeing to pay them on the contract day of payment. In this manner the Western Building Material Company lent its credit to the cement companies for the period between the times of delivery and the times of payment according to the contract. There were a large number of these drafts and a list of them is in evidence. (Tr., pp. 340, 341.) The first of them is dated only a day or so after the interview between Howard and Dingee in which the purchase of the Northwestern bonds and stocks was arranged. From this coincidence of dates counsel has endeavored to make out that it was understood between Howard and Dingee that Howard would grant these acceptances if Dingee would take care of the Northwestern bondholders. Howard denies positively that there was any connection between the purchase of the stocks and bonds by the Standard and the acceptance of the drafts by the Western Building Material Company. (Tr., pp. 961, 963.) Why counsel wish to make out a connection we cannot see. We wish there were one. If

there were, there would be still another perfectly proper and valid consideration for the purchase. The Western Building Material Company was under no obligation to give these acceptances and to lend its credit. Its doing so was of the very greatest advantage to the cement companies. As Mr. Young testified (Tr., pp. 729, 730), it was the credit of the Western Building Material Company extended in this manner that kept the cement companies going for months. The cement companies could afford to pay, and to pay heavily, for the extension of that credit. If the Western Building Material Company had chosen to exact as the condition and consideration for its extending its credit that the Standard should purchase the Northwestern stocks and bonds, this in itself would have constituted a valid and sufficient reason and consideration for the purchase.

We believe that we have now covered all the essential facts bearing, or claimed to bear, on the question of fraud and conspiracy and counsels' contention regarding them. We submit that there is no ground whatever for a finding that there was fraud. Fraud is not lightly to be found. There must be evidence, and convincing evidence, to overcome the presumption of honesty and good faith to which every man is entitled. It is true that fraud can usually, or at least frequently, be shown only by way of inference from the facts directly appearing in evidence, but these inferences must flow naturally and strongly and convincingly from the evidenciary facts. In this case it is only by the most

strained inferences, by disregarding the natural deductions and probabilities, and by presuming men to be dishonest instead of honest, that it is possible to find any evidence whatever of fraud or conspiracy or wrongdoing on the part of Howard, Evans, Smith, or Spencer.

IV.

The defense of want of consideration.

Little need be said as to this defense. It is apparent that it does not exist. In order that the defense of want of consideration exist it is not sufficient that it appear that the consideration was inadequate, or even grossly inadequate, but it must appear that there was no consideration at all. Now in this case it is perfectly evident that there was a consideration for the notes sued upon, viz: the stocks and bonds of the Northwestern Company. Whether that consideration was adequate or inadequate is another question, but its existence puts an end at once to any claim that there was no consideration for the notes.

We would not be understood as saying that inadequacy of consideration, if it had existed, was not a factor to be considered. The point is that if it had existed it was not in and of itself a defense, but it was material only as a factor in determining whether or not there was fraud. Even if the consideration had been inadequate and yet it appeared that there was no fraud, there was no defense. The mere fact that the purchase of the

Northwestern stocks and bonds may have turned out to be unfortunate is not in and of itself a ground for rescinding the purchase. We cannot help adding at this point that if that purchase has turned out to be unfortunate it is not due to the purchase having been a bad one at the time, but to the Standard Company and its officers failing to go ahead with the northern project which had been conceived and started in the Standard's interest. But however this may be, the present point is that the notes in suit were supported by a consideration and accordingly are valid instruments, unless there exists some further defense such as that of fraud or want of authorization. The defense of want of consideration does not exist. The principles involved in the discussion of this point are elementary and we feel that we need cite no authorities to support them.

V.

The defense of want of authorization for the execution of the notes.

This defense is based upon the fact that the meeting of the Board of Directors which authorized the execution of the notes in suit was attended only by a bare quorum of three, of whom Mr. Dingee was one. It is said that Mr. Dingee had such a personal interest in the transaction as to disqualify him from voting and that, therefore, there was no valid resolution passed. The answer to this is twofold:

(a) The Plaintiff in Error is estopped from making this defense by the certificate of its secretary, accepted and acted upon by the bondholders.

One of the requirements of the bondholders, notably of Mr. Evans, as a condition to the sale of their stocks and bonds to the Standard in return for the latter's notes, was that the transaction be properly authorized by the Standard's Board of Directors, and it was definitely understood that this would be done. (Tr., p. 189; letter of Howard to Dingee of March 27, 1908, p. 879 of Transcript.) For the purpose of assuring the bondholders that it actually had been done and that the transaction was fully authorized on the part of the Standard Coporation, there was delivered to Mr. Norcross, at the time he turned over the stocks and bonds of the Northwestern and received the Standard's notes, a certificate of the secretary of the Standard, under its seal, to the effect that a resolution, which by its terms fully authorized the transaction, had been unanimously adopted by a majority of the corporation's Board of Directors at a meeting duly called and held. This certificate was accepted by Mr. Norcross for and on behalf of the bondholders as an assurance that a resolution had been actually and properly passed. Neither Mr. Norcross nor any of the bondholders knew personally that any meeting of the directors had ever been held or that any resolution of any sort had been passed at such meeting, but they were not obligated to inform themselves personally about these matters. They had a right

to rely upon the formal certificate of the secretary of the corporation under its seal that there was such a valid resolution. It would make no difference if there had never been any meeting of the Board of Directors at all. The corporation would be estopped from showing that fact.

Hawley v. *Gray Bros.,* 106 Cal. 337;

Baird v. *Bank of Washington,* 11 Sergeant & Rawles, 411, 415.

(b) Dingee had no such interest in the transaction as to disqualify him from voting as a director of the Standard Corporation.

The rule that any transaction between a corporation and a director or other officer, which is effected on behalf of the corporation through the instrumentality or by the vote of such director or officer, may be avoided at the option of the corporation for that reason alone, regardless of the fairness or unfairness of the transaction, is based upon the general principle of public policy that a trustee cannot in his trust capacity deal with himself and that if he endeavors to do so the transaction may be avoided by the *cestui que trust* as of course. The most casual examination of the authorities holding such transactions voidable will reveal this to be the ground upon which they are put. See, for instance,

Pacific Vinegar Works v. *Smith,* 145 Cal. 352, 360 to 362.

The rule is accordingly confined to those cases which present the feature of a trustee attempting to deal with himself, that is, so far as corporate transactions are concerned it is confined to transactions in which the director or officer is actually an adverse party. It has no application to those cases in which the transaction is between a corporation and a third party, but is effected through the vote or instrumentality of a director or officer who has some personal or special interest or motive for having the transaction arranged.

We must not be understood as saying that such personal or special interest or motive on the part of the director or officer may not avoid the transaction. It may well do so. The point is that it will not do so unless the transaction was unfair. In other words, the question in such cases is one of actual fraud.

> *Herbert Kraft Co.* v. *Bryan,* 140 Cal. 73, 79;
> *Sacramento Bank* v. *Copsey,* 133 Cal. 659.

Now, in this case the transaction was not between the Standard and Dingee, but between the Standard and third persons, and, accordingly, unless there was actual fraud, the transaction could not be avoided merely by reason of some motive or interest on the part of Dingee. We do not desire to discuss further the question of such actual fraud. We believe the charge of conspiracy and fraud against Mr. Howard, Mr. Spencer, Mr. Evans and Mr. Smith to be simply preposterous.

It may not be amiss, however, to say something on the subject of Mr. Dingee's action in voting for and

putting through the purchase of the Northwestern bonds and stocks. The record discloses acts on the part of Mr. Dingee which, to put it very mildly, are hardly consistent with any great degree of scrupulousness. But in this particular transaction we believe he was acting simply for the best interests of the two local cement companies which he controlled and that he is not subject to just criticism. In fact it was just as much to the Standard Corporation's interest that the Northwestern bondholders be settled with as it was to Dingee's personal interest. As we have said, it was vital to the Standard to have such settlement. If it were not made both the Santa Cruz and the Standard were certain to be sued for the Northwestern moneys which had been practically stolen to help those two corporations out, and such a suit, and the disclosures which it would necessarily involve, would mean bankruptcy for both companies.

Under these circumstances we do not believe the transaction was affected by the alleged personal interest of Mr. Dingee. That interest, in fact, was very slight. The wrongs which he committed upon the Northwestern were done on behalf of the Standard and the Santa Cruz. No threat of proceedings against him, either civil or criminal, had been made to him. Absolutely the only intimation to him of such a thing was in the letter of Evans to Howard of March 4, 1908, which Howard apparently sent to Dingee, and to which we have already referred. The statement in that letter was

simply to the effect that Dingee was criminally liable according to the laws of British Columbia, and it certainly cannot be considered that such a statement, particularly when not made directly to Dingee but in a private letter to a third person, gave Dingee such a personal interest as to invalidate the subsequent purchase by the Standard. We all know how slight is the danger of criminal prosecution in such cases in this country. Mr. Dingee must have known this also. He was too old and experienced a bird to be seriously alarmed by a statement of the almost casual character of that of Mr. Evans. He undoubtedly did not like the statement, but that he really feared a criminal prosecution is not to be believed. The utmost that he could have really feared was that the Northwestern bondholders would pursue their civil remedies, as they had a perfect right to do, and show up the financial condition of his cement companies and involve them in the difficulties that were certain to ensue upon such a disclosure. The thing that really impelled Dingee was the protection of those companies, of which the defendant was one. We submit that the purchase of the Northwestern bonds and stocks by the Standard was in fact for the best interests of that company and was not affected in any way by any personal fear or interest on the part of Mr. Dingee.

We will not discuss this matter further than to repeat what we have already said, that Howard and the bondholders made no attempt of any sort to bring any pressure to bear upon Dingee. The diversion of the North-

western moneys was not discussed with him. (Tr., pp. 560, 565, 566, 962.) In fact there had never been any discussion with him as to what he would do about the Northwestern matter. (Tr., pp. 962, 963.) The bondholders had no plan of action when they sent Mr. Howard to Mr. Dingee. He was simply to learn what Dingee would do. Dingee was not moved by any agreement or understanding that he or Bachman was to be absolved from responsibility. His responsibility was never discussed and no proposition of any sort was made to him by the bondholders. It was he that made a proposition to them, not they to him. They simply went to him through Howard and asked him what he proposed to do about the Northwestern plant, and he said he intended to go on with it, but not immediately, because of hard times, but that if Howard's friends were uneasy the Standard would buy their holdings. The bondholders accepted this offer, which was Dingee's proposition and not theirs. Nothing further or different was ever considered between them. (Tr., pp. 966, 968, 977, 978.) Certainly such a transaction was perfectly upright and legal.

VI.

The effect of the failure of the Standard Corporation to return, or offer to return, bonds and stocks of the Northwestern Company received in return for the notes.

The effect of the failure of the Standard Corporation to return, or to offer to return, the consideration which it received for the issuance of its notes is that it does not now make a particle of difference whether those notes were originally valid or invalid. It is too late for the Plaintiff in Error to deny responsibility upon them. It received the stocks and bonds which were the consideration for the notes at the time the latter were executed, that is, in May, 1908. The transaction, whether duly authorized or not, or whether fraudulent or not, was spread at large on the minutes of the corporation. This was notice to the corporation of the transaction. Furthermore, Mr. Young, the secretary of the defendant, who is not claimed to have been a party to the alleged fraud, knew of the transaction from the beginning, and in November or December, 1908, after there had been a complete change in the Standard's management, called the attention of the new management to the existence of the notes and to the transaction in connection with which they were issued. (Tr., pp. 752, 753.) Later, between that time and May, 1908, he discussed the matter with other officers of the

company. (T., pp. 937, 938.) This new management has continued to the present time and has not only not been subject to the dictation of Mr. Dingee, but, as may fairly be inferred from the record, has been positively hostile to him. Nevertheless, from the day on which the new management was informed of the transaction down to this, a period of four years, during which the securities given in consideration for the notes have been steadily deteriorating, nothing whatever has been done by the Plaintiff in Error to return, or to offer to return, or even to put itself in a position where it could return, those securities. This is a complete ratification of the transaction by acquiescence and estoppel both. This is not open to serious dispute. The code section is sufficient to settle it.

Section 1691 of the Civil Code reads:

> "Sec. 1691. Rescission, when not effected by consent, can be accomplished only by the use, on the part of the party rescinding, of reasonable diligence to comply with the following rules:
>
> "1. He must rescind promptly, upon discovering the facts which entitle him to rescind, if he is free from duress, menace, undue influence, or disability, and is aware of his right to rescind; and,
>
> "2. He must restore to the other party everything of value which he has received from him under the contract; or must offer to restore the same, upon condition that such party shall do likewise, unless the latter is unable or positively refuses to do so."

The question is likewise fully settled by the authori-

ties. Thus, for an instance in which it was held that the defense of fraud was not available in an action upon a promissory note where the maker of the note had failed to return promptly the consideration for the note (some mining stocks), see

Gifford v. *Carvill,* 29 Cal. 589, 592.

To the same effect see also:

Hernan v. *Haffenegger,* 54 Cal. 161;
Gamble v. *Tripp,* 99 Cal. 223;
Martin v. *Burns Wine Company,* 99 Cal. 355;
Kelly v. *Owens,* 120 Cal. 502;
Westerfeld v. *N. Y. Life Ins. Co.,* 129 Cal. 68;
McGue v. *Rommel,* 148 Cal. 539.

For an instance where the defense of *ultra vires* was not permitted to a corporation when it had failed to return the consideration which it received through the transaction, which it now claimed to be beyond its power, see:

Main v. *Casserly,* 67 Cal. 127;
Lawrence v. *Johnson,* 131 Cal. 175.

For an instance in which a corporation was held upon its promissory notes, although it appeared that they had been issued both without the necessary authorization of its board of directors and by an officer who was personally interested in and benefited by their issuance, see:

Phillips v. *Sanger Lumber Co.,* 130 Cal. 431.

See also:

Barr v. *N. Y., etc., R. R. Co.,* 125 N. Y. 263;
White v. *Latham,* 143 U. S. 567;
Twin Lick Oil Co. v. *Maybury,* 91 U. S. 587;
Gribble v. *Columbus Brewing Co.,* 100 Cal. 67;
Buena Vista etc. Co., v. *Tuohy,* 107 Cal. 243.

The reply of counsel for Plaintiff in Error to these authorities and the rule enunciated by them seems to be:

First, that the Standard never received the Northwestern stocks and bonds which were the consideration for the notes;

Second, that if the Standard did receive the stocks and bonds, it subsequently turned them over to the Northwestern and that there is an exception to the general rule requiring the return of the consideration before there can be a rescission, to the effect that when the defrauded party has parted with or lost the consideration, he is relieved from the necessity of returning it.

Third, that the Northwestern stocks and bonds were valueless and therefore need not be returned.

We will take these points up in order:

First: The Standard did receive the stocks and bonds of the Northwestern which were the consideration for the notes in suit;

That the stocks and bonds of the Northwestern were actually delivered to the Standard does not admit of dispute. They were delivered in accordance with a letter by Mr. Norcross to the Standard Corporation

itself. (Letter of May 4, 1908, pp. 730-733 of Transcript, and Young's account, pp. 734 and 735.) The stock certificates were not endorsed in blank but were endorsed to the order of the Standard, and later when the stock was transferred into the name of Mr. Young, Secretary, the certificates were indorsed by the Standard. (Tr., pp. 711-715.) The Standard likewise gave Mr. Norcross a receipt in its name for the stocks and bonds. (Tr., p. 745.)

The contention of counsel is that nevertheless the Standard did not actually receive the stocks and bonds because, as a part of the alleged fraudulent scheme, it was understood between Dingee and the bondholders that the stocks and bonds were really to go to the Northwestern and not to the Standard, and that, pursuant to this understanding, they were immediately transferred into the treasury of the Northwestern.

The point of the matter is that, regardless of whether or not the sale to the Standard was accomplished by fraud or other wrongful means, there is not one particle of evidence to justify the statement that there was any understanding that the stocks and bonds were to go to the Northwestern and not to the Standard. No one testifies to any such understanding and there is nothing from which it can be inferred. On the contrary, it is positively denied by all the parties to the transaction, it is inherently improbable, and the accompanying circumstances point not only to a contrary conclusion, but to the fact that the stocks and bonds never were turned over to the Northwestern.

Evans, Howard and Smith all testify that they had no understanding as to what disposition would be made of the stocks and bonds after their delivery to the Standard and that they did not even know until the trial that it was claimed that the Standard had turned them over to the Northwestern. (Tr., pp. 964-966, 968, 977, 978.)

The thing is inherently improbable because Howard and the bondholders had absolutely no further interest in the Northwestern or in what disposition was made of the stocks and bonds, and there was no occasion for any such understanding.

The accompanying facts are:

(a) In November, 1908, when Mr. Young was listing these notes as liabilities of the Standard, he put them down as given for the "purchase" of the Northwestern bonds and stocks without any qualification or explanation. (Tr., p. 930.) He would have been extremely unlikely to have done this if he had conceived that the purchase had not been in fact for the Standard.

(b) No entry was made in the books of the Northwestern to show the cancellation of the bonds or stocks. Young testifies that, in the way in which the capital account of the Northwestern was kept, no entry would have been made in any case as to the stock. (Tr., pp. 939, 940, 941.) But this is not true as to the bond account. As to it an entry would in ordinary course, according to the manner in which the company's books were kept, have been made of the surrender of any out-

standing bonds, and there is no such entry. (Tr., pp. 940, 941.) If the stocks and bonds were really surrendered to the Northwestern, then the books of that company do not truly show the condition of that company as to either its stocks or bonds.

(c) There is no charge or claim made by the Standard against the Northwestern on account of the transaction, and yet if the Standard had given its notes to make a purchase not on its own behalf, but on behalf of the Northwestern, an entry of a charge against the Northwestern for the liability thus assumed for it would certainly have been made. Later, when the matter of waiving the statute of limitations as between the companies came up, the Standard and Santa Cruz waived the statute as to claims against them by the Northwestern, but the Northwestern made no waiver as to claims against it by the Standard, for the very apparent reason that it was not conceived that any claim existed. (Tr., p. 948.) Yet if defendants' counsels' theory is correct such a claim must have existed. It is to be noted that this matter of waiving the statute of limitations came up after the new management was in charge of the cement companies and was informed as to this transaction.

Finally we would call attention to the fact that Mr. Young, the Secretary of the Standard, has all along had and now has possession of the bonds, (Tr., pp. 747, 748, 943), and that he had possession of the stock at the time he first called the attention of the new man-

agement of the Standard to the fact of these notes being out. It was, therefore, possible at that time for the Standard to return both the stocks and the bonds, and it was incumbent upon it to act promptly if it desired to disaffirm the notes. Furthermore, it has all along been possible for the Standard to return the bonds, if not the stocks, and it has never done so, or offered to do so. It certainly cannot disaffirm the notes without returning as much of the consideration as it is within its power to return.

In this connection we would ask the court to consider what action should have been taken by the Plaintiff in Error if it was to disaffirm the transaction promptly, as it was its duty to do if it would disaffirm at all. Certainly it was its duty promptly to put itself in a position where it could, as far as possible, return the consideration which the bondholders had given. It was its duty to demand of Mr. Young, who had the custody of both the stocks and bonds for months after the new management of the Standard knew of the existence of the notes and why they had been given, to join with the Standard in returning them to the bondholders and in disaffirming the purchase. No such demand has ever been made and in fact no attempt of any sort has been made to return to the bondholders the securities which they turned over in consideration for the defendant's notes. (Tr., pp. 751, 943.) Can there be any doubt but that if such a demand had been made Mr. Young would have complied with it and joined in a tender of the North-

western stocks and bonds to their former owners? (See his testimony on pp. 943 and 955 of Transcript.)

Assuming that the Northwestern was a wholly independent concern, can there be any doubt but that if a demand had been made upon it that it join in a tender back of the stocks and bonds, it would have done so? If the theory of defendants' counsel be correct, the Northwestern got the stocks and bonds through a fraud upon the Standard, and it would either have to protect the Standard against the latter's liabilitiy on its notes or join with it in disaffirming the whole transaction. As between the alternatives of paying the notes, aggregating $90,000, or joining in a disaffirmance of the transaction, the Northwestern would certainly have chosen the latter course.

But suppose the Northwestern had simply refused to do anything, and Mr. Young and it had maintained that it owned the stocks and bonds, what was the course which the Standard should have pursued, if it were to fulfill the legal obligation resting upon it to disaffirm the transaction promptly upon discovering the fraud? The course is clear. The Standard should have immediately brought suit against both the bondholders and the Northwestern to disaffirm the whole transaction and through the process of the court to compel the cancellation of the notes and the return of the Northwestern stocks and bonds which that company had received without a dollar of consideration moving from it. If the facts were as defendants' counsel claim they

were, such a suit could have been maintained, and it was the duty of the Standard to bring it, and to bring it promptly, and thus disaffirm its liability on the notes. It has never done this, or done anything else looking to a disaffirmance and rescission of the transaction. Not having done so, it cannot now escape liability on the notes.

Second: It is not true, as counsel claim, that there is an exception to the rule requiring a return of the consideration as a condition of the disaffirmance of liability, to the effect that, if the party entitled originally to disaffirm has parted with or lost the consideration, he can still disaffirm. The rule is that in such a case the right to disaffirm is lost and the injured party must rely solely upon an action for damages for the fraud or other wrong perpetrated upon him. We do not believe that the stocks and bonds in this case were in fact ever turned over to the Northwestern. If they were, they were turned over by the Standard itself without the knowledge or connivance in any way of the former bondholders. There is not a scintilla of evidence to justify a conclusion to the contrary. This being the case, the Standard lost its right of disaffirmance, if it ever existed, and is relegated for relief to an action for damages. This is settled by the California decisions. Thus in

Herman v. *Haffenegger,* 54 Cal. 161,

the plaintiff sought to recover back, on the ground of fraud, certain land which he had sold. The considera-

tion which he received does not appear with exactness in the report of the case, but it appears at the bottom of page 163 that it consisted, in part at least, of an interest in something—in just what it does not appear—and certain shares. This interest and these shares the plaintiff had sold and did not have at the time he offered to rescind. Upon these facts the court held (p. 164):

> "The plaintiff had received of defendant something of value, and we do not find in the testimony any return or offer to return to defendant, that which plaintiff had received of him. The plaintiff, indeed, as the testimony shows, did not then own what he had so received. He could not maintain the action until he had so returned, or offered to do so. This was a condition precedent to his maintenance of the action. And as he did not comply with this requisite, the nonsuit was properly granted."

In

Bailey v. *Fox,* 78 Cal. 389,

the plaintiff sought to rescind, on the ground of fraud, a purchase from the defendant of a one-third interest in a stock of hardware and agricultural implements. The plaintiff offered to rescind before bringing his action, but at that time a considerable portion of the stock of goods had been sold. The lower court found there was fraud and decreed rescission. Upon appeal the judgment of the lower court was reversed, the Supreme Court saying:

> "The judgment in favor of the plaintiffs is erroneous for several reasons:

"1. . . . . .

"2. The tender made upon an offer to rescind was insufficient.

"3. It appears to have been impossible, at the time of the offer to rescind, to place the defendant in statu quo.

"4. . . . . .

The Court then proceeds to discuss the several reasons so summarized, and of those numbered 2 and 3 it says:

"2. The tender made was not of the goods purchased, as a great part of them had been sold. The offer was to deliver the goods on hand, and pay the amount realized from the sale of those disposed of. This was not sufficient. Upon a rescission, the defendant, before paying back the purchase money and delivering up the notes, was entitled to receive the identical things sold. He was not bound to take the price at which they were sold. That might, so far as we know, have been less than their value. But whether it was or not, the rule is well settled, that where the party complaining has parted with the thing purchased, he cannot rescind, but must resort to an action for damages. *(Herman* v. *Haffenegger,* 54 Cal. 161. *Cobb* v. *Hatfield,* 46 N. Y. 533; Benjamin on Sales, Sec. 452.*)*

3. Again, at the time the offer to rescind was made, it had become impossible by the act of the plaintiff himself, or jointly with the other active partner, to place the defendant in statu quo.

As a result of the sale, a partnership had been formed, as we have stated, and the whole of the stock had become partnership property, in which Meinecke, who was not made a party to this action, had an interest. A large part of the stock had been sold, and new stock purchased on credit, for which the defendant as well as the other partners was personally liable. This being

the situation of affairs, it was utterly impossible to place any of the parties in statu quo. It is well settled that under such circumstances there can be no rescission of the contract. (Civ. Code, Sec. 1691; *Herman* v. *Haffenegger,* 54 Cal. 161; *Pullman* v. *Alley,* 35 N. Y. 637; *Gould* v. *Cayuga County National Bank,* 86 N. Y. 75; *Sinclair* v. *Neil,* 8 Hun. 80; *Hogan* v. *Meyer,* 5 Hill, 389; *Matteawan Co.* v. *Bentley,* 13 Barb. 641; *Kerr on Fraud,* 48, 328; *Benjamin on Sales,* Sec. 452; *Fry on Specific Performance,* Sec. 706; 1 *Wharton on Contracts,* Sec. 286; *Cobb* v. *Hatfield,* 46 N. Y. 533.)

Kelly v. *Owen,* 120 Cal. 502,

was decided in banc on rehearing and without dissent. It was an attempt to rescind an exchange between the plaintiff and the defendant of certain land in return for certain shares of stock. The ground of the action was fraud. The plaintiff, however, had permitted the shares of stock received by him to be sold for assessments. The rules governing rescission are discussed at some length, together with the exceptions—or rather the apparent exceptions, for they are but apparent—to the requirement of a full restoration of the consideration received by the rescinding party, but no such exception as counsel rely on is stated. On the contrary, the decision directly holds that because the plaintiff no longer owned the stock, since it had been sold for assessments, and, therefore, could not restore it, there could be no rescission, and the judgment of the lower court to the contrary is reversed.

The case of

California etc. Co. v. *Schiappa-Pietra,* 151 Cal. 732,

is cited by defendants' counsel in support of their contention. In view of the fact that this decision quotes at length from *Kelley* v. *Owens, supra,* and purports to follow it, it would be rather remarkable if, in direct contravention of that decision, it allowed the exception for which counsel contend. But it does nothing of the sort. It was an action brought for the very purpose of effecting the rescission of a purchase of land, the ground alleged being fraud. The complaint set out at length the facts of the case, from which it appeared that it was impossible for the plaintiff to tell in advance of an accounting by the court just what the defendant would be entitled to in order to effect a full restoration and to place the parties in *statu quo.* The complaint, accordingly, did not allege a prior restoration, or offer to restore, but prayed that the court determine just the sum the plaintiff should restore, and then offered to restore it. The complaint was demurred to, and the demurrer sustained in the lower court, and judgment rendered upon the plaintiff's refusal to amend. Upon appeal the whole point of the discussion was simply as to whether there had to be *prior to the action* a restoration or offer to restore. That there had to be a full and complete restoration was expressly assumed. The discussion was simply as to the cases in which a plaintiff could maintain an action to effect a rescission without having, *prior*

to the action, made an offer to restore. It was held that such prior offer would not be required where the facts were such that a decree of the court was necessary either by way of accounting or otherwise, in order to determine just what the defendant would be entitled to upon a restoration, or where the plaintiff could not safely make the offer because he was entitled, in case of rescission, to a charge upon the thing to be restored, which charge would be lost in case the thing were delivered unconditionally to the defendant. There is nowhere in the case a hint even that where the plaintiff has parted with the consideration so that he cannot restore it, he can still rescind.

In this case there are no complicated facts requiring a decree of court in order to enable Plaintiff in Error to know what it should restore. It simply had to offer to restore the stocks and bonds received. But over and beyond all this is the fact that the defendant does not seek to rescind. It seeks no such relief. The granting of such relief by the court would be entirely beyond and outside the pleadings. The answer of the defendant, so far from seeking to rescind and offering to restore the consideration, alleges that it never received any consideration. This allegation was vital to the answer and without it the answer would have been open to general demurrer. The uncontradicted facts show that the allegation is untrue, and, being untrue, there is a fatal variance between the proof and the pleadings and the plaintiff is entitled to judgment.

Third: There remains the contention of defendants' counsel that no return of the stocks and bonds was required because they were worthless. It is true that where the consideration received is absolutely worthless so that its return would be wholly useless and meaningless, it need not be returned as a condition to a disaffirmance. But the consideration must, as we have said, be absolutely worthless. If it has any value at all, it must be returned.

The authorities in support of this statement of the rule are numerous and uniform. Thus in

Gifford v. *Carvill,* 29 Cal. 589,

already refered to, the Court said:

> "There is no averment in the answer, and no evidence, that defendant rescinded the contract and returned, or made a tender of the stock, and no averment that it was of no value, unless the averment that it was 'of little or no value' can be so construed. If it was not absolutely without value to either party—if it had a little value—there was a consideration which, being actually retained, did not afterward fail, and it was necessary to rescind the contract and return the consideration within a reasonable time after the discovery of the fraud. We are inclined to think that the allegation cannot be regarded as an averment that there was no value. It must be construed most strongly against the pleader, and the implication is that it might have been of some, though little, value."

See also:

Wolf v. *Dietzsch,* 75 Ill. 205;
Morrow v. *Rees,* 69 Pa. St. 368;
Connor v. *Henderson,* 15 Mass. 319; 8 Am. Dec. 103;
Perlay v. *Balch,* 23 Pick. 83; 34 Am. Dec. 56;
Haase v. *Mitchell,* 58 Ind. 213;
Coolidge v. *Brigham,* 42 Mass. 547;
Cook v. *Gilman,* 34 N. H. 556;
Evans v. *Gale,* 21 N. H. 240, 245;
Bassett v. *Brown,* 105 Mass. 55.

Now, in this case it cannot be contended that the Northwestern stocks and bonds were absolutely worthless at the time they were received by the defendant, or that they have become so since. The bonds constituted a first lien on all the assets of the company. We have already gone into those assets at some length and there is no need of our doing so again. Suffice it to say that there is one asset alone which would make the bonds of very considerable value, viz: the right which the Northwestern Company has all along had, and still has, against the Santa Cruz Company to recover something over $105,000 for money illegally diverted to the use of the latter, and to recover something over $90,000 because of the stock of the Bellingham Bay and B. C. R. R. Co., which was illegally pledged to secure a debt of the Santa Cruz Company.

We accordingly respectfully submit that, no matter whether or not the defendant originally had any valid

defense to the notes in suit, that defense has been lost by the failure of the defendant promptly to return, or to offer to return, the consideration which it received for the notes.

We respectfully submit that in no possible view of this case is the judgment against the Plaintiff in Error either erroneous or unjust, or should it be reversed.

Respectfully submitted,

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